

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service in Illinois. 86 Ill. Adm. Code 140.101. (This is a GIL.)

August 10, 2006

Dear Xxxxx:

This letter is in response to your letter dated June 27, 2005, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

ABC is a state and local tax consulting firm located in CITY/STATE. As such, we contract with many multi-state clients in various industries. In doing so, we pride ourselves in researching all aspects of specific industry transactions in order to better serve our clients both current and future. To this end, we respectfully request a written opinion on the following scenario.

### **Scenario**

Company A is a marketing and sales organization who developed a proprietary process for administering a type of dental procedure by use of a machine and certain catalysts. In order to market its proprietary process, Company A will contract with Dentists to provide marketing, appointment services, and payment services in return for the Dentists using their proprietary process to provide the dental services. In doing so, Company A will provide at no charge their machine used to perform the procedure. All fees charged to the Dentist are for marketing, setting appointments, payment collection and remittance to Dentists and overall public relations followup. The invoices will reflect service fees, procedure items, and over-the counter items as separate line item charges. There will also be a de minimus amount of over-the-counter products sold to the Dentists. Under the following transactions, what would the tax responsibilities be for Company A?

1. Company A pays the sales and use tax upon purchase of the machines and subsequently provides the machine free of charge with the provision the customer uses Company A's proprietary process to conduct the procedure. Company A charges a service fee for marketing, setting appointments, and overall public relations for the proprietary process. There are also miscellaneous over the counter items sold by the medical provider which are provided by Company A to the customer.

Question: Pursuant to Illinois administrative rules, would the state of Illinois consider the placement of the machinery free of charge as a nontaxable transaction with the tax paid up front on the purchase of the machines by Company A?

Question: If Company A invoices the non-taxable services separately from the over-the-counter (otc) items (as described above), are only the otc items taxable, and could Company A accept a resale certificate from the medical professional for such otc items?

2. The aforementioned proprietary process by use of the machine and certain catalytic reactions effects a change on the individual patient.

Question: Since the machine does affect a chemical or physical change on the patient, would the machine qualify as processing equipment under Illinois' administrative rules governing manufacturers or processors?

Question: If so, would the machine qualify for exemption at the time of purchase by Company A?

Based upon your response, we will be better able to serve our clients. Your prompt attention to this request is greatly appreciated. If there are any questions please call me.

## **DEPARTMENT'S RESPONSE:**

The sale of marketing and payment services that is accompanied with the transfer of tangible personal property such as reports is subject to liability under the Service Occupation Tax Act. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service in Illinois. Servicemen incur either Service Occupation Tax liability or Use Tax liability in these transactions. The tax consequences, as explained below, depend upon the method used to calculate the liability.

In Illinois, servicemen are subject to the Service Occupation Tax (SOT). Liability for this tax is contingent upon the transfer of tangible personal property to a service customer. Servicemen may calculate their tax base in one of four ways:

- 1) Separately stated selling price;
- 2) 50% of serviceman's entire bill;
- 3) SOT on his cost price if he is a registered de minimis serviceman; or,
- 4) Use Tax on his cost price if he is an unregistered de minimis serviceman.

Please see 86 Ill. Adm. Code 140.101, the Basis and Rate of the Service Occupation Tax.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. Such servicemen collect a corresponding amount of Service Use Tax from their customers.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction-by-transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen collect a corresponding amount of Service Use Tax from their customers.

De minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act may use the final method of determining tax liability. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. Servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

Under the Use Tax Act, a tax is imposed upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101. In other words, the Use Tax applies when tangible personal property is purchased anywhere at retail from a retailer and brought into this State for use. The purchaser would get credit against his or her Illinois Use Tax obligations for taxes properly due and paid in another state. See 86 Ill. Adm. Code 150.701 and 150.310(a)(3).

In Illinois, lessors are considered to be the users of the property which they lease, and incur a Use Tax liability upon the purchase of that property. They do not collect any tax from their customers. See Sections 130.220 and 130.2010.

For over-the-counter sales, please note that if a de minimis serviceman makes retail sales he or she is required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such a serviceman would be a registered de minimis serviceman and could use the third method listed above. See 86 Ill. Adm. Code 140.109. A retailer in this situation may accept a resale certificate for tangible personal property

If a sale of service is not taxable due to a particular exemption, the serviceman must maintain the necessary documentation (e.g. exemption certificate) in his records to support the non-taxable nature of the transaction, 35 ILCS 115/12 and 120/7. The nontaxable nature of a transaction should not affect invoice preparation based upon the appropriate calculation method, as discussed above. As such, persons may accept a resale certificate from purchasers for over-the-counter sales,

providing the purchasers intend on reselling the tangible personal property and not consuming the property in rendering their service. The over-the-counter sales should be separately billed and invoiced from the marketing and payment services.

The Department does not consider a machine that may cause a chemical or physical change on an individual person as being a manufacturing process. As stated in 86 Ill. Adm. Code 130.330(b)(2): "The manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant." Therefore, the machine in question would not qualify for the manufacturing machinery and equipment exemption.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

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Associate Counsel

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